

**LEGISLATIVE SERVICES AGENCY
OFFICE OF FISCAL AND MANAGEMENT ANALYSIS**

200 W. Washington, Suite 301
Indianapolis, IN 46204
(317) 233-0696
<http://www.in.gov/legislative>

FISCAL IMPACT STATEMENT

LS 6083

BILL NUMBER: SB 132

NOTE PREPARED: Dec 3, 2014

BILL AMENDED:

SUBJECT: State Income Tax Exemption For Military Income.

FIRST AUTHOR: Sen. Alting

FIRST SPONSOR:

BILL STATUS: As Introduced

FUNDS AFFECTED: X **GENERAL**
DEDICATED
FEDERAL

IMPACT: State & Local

Summary of Legislation: The bill provides a 100% income tax deduction for all military service income received by an individual or the individual's surviving spouse. It removes the minimum age requirement for an individual to deduct income received as retirement or survivor's benefits for military service.

Effective Date: January 1, 2016.

Explanation of State Expenditures: *Department of State Revenue (DOR):* The DOR would incur some administrative expenses relating to the revision of tax forms, instructions, and computer programs to reflect the changes to the military income deduction. The DOR's current level of resources should be sufficient to implement these changes.

Explanation of State Revenues: *Summary* - The bill increases the military income deduction and extends it to taxpayers who are currently not eligible for the deduction. These changes would be effective beginning in tax year 2016, with the full revenue impact beginning in FY 2017. The estimated revenue loss in FY 2017 and FY 2018 is summarized in the table below. The revenue loss could potentially grow by 4% to 5% annually thereafter.

With an effective date of January 1, 2016, it is likely that some individuals may adjust their withholding to account for this increased deduction. To that extent, the revenue loss could begin in FY 2016.

| Type of Military Income | FY 2017 Revenue Loss (in millions) | FY 2018 Revenue Loss (in millions) |
|--|---|---|
| Military Pension (Retirees 60 years old or older) | \$8.0 | \$8.0 |
| Military Pension (Retirees under 60 years old) | 6.7 | 6.7 |
| Survivor's Benefit (Survivors 60 years old or older) | 0.6 | 0.6 |
| Survivor's Benefit (Survivors under 60 years old) | 0.7 | 0.7 |
| Full-Time Active Duty Pay | 13.5 | 13.9 |
| Armed Forces Reserve/National Guard Regular Pay | 6.8 | 7.3 |
| Total | \$36.3 | \$37.1 |

Additional Information - The bill does the following:

- (1) It extends the individual adjusted gross income (AGI) deduction for military pension and survivor's benefits to individuals receiving these benefits who are under the age of 60 beginning in 2016.
- (2) It increases the individual AGI deduction for military pension and survivor's benefits from a maximum of \$5,000 to a full deduction beginning in 2016.
- (3) It increases the individual AGI deduction for military service pay earned by individuals who are members of an active or reserve component of the U.S. armed forces. The deduction would be increased from a maximum of \$5,000 to a full deduction beginning in 2016.

The estimates are based on pay and benefit information and personnel, retiree, and survivors counts from 2005 to 2014 from the U.S. Department of Defense (DOD), Defense Manpower Data Center (DMDC). These data provide (1) counts of active duty, Armed Forces Reserve, and National Guard personnel reporting Indiana as their state of legal residence and annualized taxable pay to those individuals; and (2) counts of military retirees and survivors reporting Indiana as their state of legal residence and monthly annuity payments to those individuals.

The estimates assume that active duty, Armed Forces Reserve, and National Guard personnel and military retirees and survivors who are 60 years old or older are already claiming the current military income deduction of up to \$5,000. It also accounts for Armed Forces Reserve and National Guard personnel who claim the current full deduction for active duty pay they may earn. The estimate does not include active duty personnel reported with an Indiana duty location who are not Indiana residents.

Current statute provides an AGI deduction for the first \$5,000 of income earned by an individual for his or her service in an active or reserve component of the U.S. armed forces, including the National Guard. The \$5,000 deduction also applies to military retirement income or survivor's benefits received by a taxpayer who is 60 years old or older. Also, current statute provides a full deduction for active duty pay earned by members

of the Armed Forces Reserve or National Guard in lieu of the deduction for military service income described above. (Note: Combat pay is already excluded from federal gross income and, as a result, is excluded from Indiana AGI.)

In 2014, the DMDC reported pay and benefit amounts for 17,176 full-time active duty personnel, 18,978 Armed Forces Reserve and National Guard personnel, 22,982 military retirees, and 4,095 survivors who reported that Indiana was their state of legal residence. The active duty pay is estimated to have totaled \$500.6 M in 2014, while pay to Armed Forces Reserve and National Guard personnel is estimated to have totaled \$271.8 M for the year. The total annuity payments in 2014 to military retirees is estimated to have totaled \$493.7 M, with the total paid to survivors estimated at \$45.7 M for the year. In tax year 2012 (the most recent tax return data available), 2,007 members of the Armed Forces Reserve and National Guard claimed deductions for active duty pay totaling about \$50.4 M.

Explanation of Local Expenditures:

Explanation of Local Revenues: Because the changes to the military income deduction will decrease taxable income, counties imposing local option income taxes could potentially experience a decrease in revenue from these taxes. Based on the current average LOIT rate of 1.45%, the estimated revenue loss in FY 2017 and FY 2018 is summarized in the table below. The revenue loss could potentially grow by 4% to 5% annually thereafter.

| Type of Military Income | FY 2017 Revenue Loss (in millions) | FY 2018 Revenue Loss (in millions) |
|--|---------------------------------------|---------------------------------------|
| Military Pension (Retirees 60 years old or older) | \$3.4 | \$3.6 |
| Military Pension (Retirees under 60 years old) | 2.9 | 3.0 |
| Survivor's Benefit (Survivors 60 years old or older) | 0.3 | 0.3 |
| Survivor's Benefit (Survivors under 60 years old) | 0.3 | 0.3 |
| Full-Time Active Duty Pay | 5.9 | 6.2 |
| Armed Forces Reserve/National Guard Regular Pay | 3.0 | 3.2 |
| Total | \$15.8 | \$16.6 |

State Agencies Affected: Department of State Revenue.

Local Agencies Affected: Counties with local option income taxes.

Information Sources: U.S. Department of Defense, Defense Manpower Data Center; OFMA Income Tax Return databases.

Fiscal Analyst: Randhir Jha, (317) 232-9556.